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Japan Cuts Discount Rate Second Time In Five Weeks

Japan joined the international round of central bank interest rate cuts by lowering its official discount rate 0.5 percentage point to 4 percent on March 7. The drop in the discount rate, the rate the Bank of Japan charges on loans to commercial banks, was intended to offset the deflationary impact of the yen's rapid appreciation on the Japanese economy. The rate had been

the strong yen to pass on any savings to customers; encouraging management to grant larger wage increases in this year's labor negotiations; and a more flexible monetary policy.

The Japanese business community is also calling for some kind of governmental response to the yen's rise, with deregulation, public works and tax cuts leading the list of options. The president of the Japan Chamber of Commerce and Industry wants Tokyo to lift restrictive regulations in the housing, railroad and retail sectors to encourage private investment. He has cited such projects as a bridge across Tokyo Bay and a new airport near Osaka, each worth $5.5 billion, as domestic demand expanders. To offset the expected decline in capital investment due to falling profits, the chorus calling for major business tax cuts is growing. While Japanese industry has often claimed that the tax-to-profit ratio is twice as high in Japan as in the United States, Ministry of Finance officials have cold-shouldered the idea of a major revision of the tax system in FY 1986.

There appears to be a wide gap between those who advocate swift remedial action and those who urge patience in responding to the effects of a strong yen. This atmosphere of indecision is likely to continue as long as the yen remains unstable and the economy sends conflicting signals. With the Tokyo summit of industrial nations approaching and continued restiveness among Japan's major trading partners, the government is likely to act more for political reasons than economic. Whether or not this will result in good policy is unclear.

Jon Choy

Yen Up Sharply Against Third-Country Currencies

Although the yen-dollar exchange rate has been in the spotlight, the yen has also appreciated against the currencies of Japan's other important trading partners. Weighted by trade with Japan's 14 largest trading partners, the yen has risen more than 42 percent during the past year and almost 31 percent since last September (see Tables). The appreciation of the yen against most other Asian currencies has matched or exceeded its rise against the dollar.

The yen's sharp advance is already beginning to affect trade flows. Korea, where imports of Japanese machinery have climbed by an average 20 percent annually in recent years, is planning to reduce its dependence on imports. The country's three major auto makers have established special task forces to increase local content. In addition, the shipbuilding industry, which meets about 40 percent of its parts requirements with imports from Japan, plans to purchase more from domestic suppliers. The appreciation of the yen may enable U.S. producers to reduce Japan's 60 percent share of Korea's machinery imports, although previously these efforts have been largely unsuccessful because many industries are geared to Japanese models and specifications.

The rise of the yen will also make it more difficult for Japanese products to compete in the United States and other foreign markets. Korean manufacturers, particularly in the area of consumer electronics, hope to

Japan's Major Trading Partners, 1985

(in millions of dollars)

Country	Two-Way Trade	Exports	Imports
1. United States	$91,068	$65,290	$25,778
2. China	18,960	12,478	6,482
3. Saudi Arabia	14,134	3,890	10,244
4. Australia	12,831	5,378	7,453
5. Indonesia	12,286	2,169	10,117
6. Korea	11,202	7,094	4,108
7. United Arab Emirates	10,079	1,163	8,916
8. West Germany	9,859	6,936	2,923
9. Canada	9,281	4,519	4,762
10. Taiwan	8,409	5,024	3,385
11. Hong Kong	7,278	6,511	767
12. United Kingdom	6,538	4,722	1,816
13. Malaysia	6,476	2,168	4,308
14. Singapore	5,452	3,860	1,592
Total	223,845	131,202	92,643
Share of Japan's Total Trade	73.4%	74.7%	71.5%

Movement of Yen Against Currencies of Major Trading Partners

Country	February 25, 1985 to February 24, 1986	September 16, 1985 to February 24, 1986
1. United States	44.0%	32.0%
2. China	62.8	43.1
3. Saudi Arabia	46.7	32.0
4. Australia	41.9	26.9
5. Indonesia	47.0	32.0
6. Korea	52.2	32.4
7. United Arab Emirates	44.0	32.0
8. West Germany	-5.3	4.0
9. Canada	42.7	33.1
10. Taiwan	44.0	32.0
11. Hong Kong	44.0	31.7
12. United Kingdom	2.6	19.5
13. Malaysia	38.3	31.8
14. Singapore	35.6	25.6
Weighted Average	42.4	30.9
Weighted Average Without Dollar	41.3	30.2

increase their sales in this country as Japanese products become more expensive. According to the Korea Development Institute, an exchange rate of Y180=$1.00 would add 1 percentage point to Korea's growth rate during the coming year and increase exports to this country by 7 percent. Moreover, industries such as steel hope to continue to expand their market share in Japan.

It is also clear from the table that the dollar has failed to appreciate substantially relative to the currencies of many important Asian nations (see JEI Report No. 9B, March 7, 1986). Despite the dollar's depreciation relative to the yen and some European currencies, it must decline relative to other currencies in order to substantially reduce the U.S. trade deficit.

Randall S. Jones

Quiet Diet Tackles Ticklish Topics

Despite a week-long disruption over domestic tax issues, the current regular session of the Diet has proceeded rather smoothly and without the usual dramatics over such issues as defense spending. Nevertheless, Diet members have not yet tackled many of the serious issues remaining from the previous regular and special sessions, several of which are critical to Japan's political situation.

The most important item on the agenda -- the FY 1986 budget -- was approved by the lower house March 10 along strictly partisan lines, with the ruling Liberal Democratic Party-New Liberal Club coalition outweighing opposition party votes. The budget will proceed to the upper house, where prompt approval is anticipated in time for the beginning of the new fiscal year April 1.

In the past, the budget has precipitated Diet debates over defense that have largely focused on cosmetic or symbolic issues while failing to address many of the fundamental policy implications of military outlays. Much of last year's debate centered solely on the intentions of the Nakasone cabinet to hold total defense spending to one percent of the gross national product. The 1986 budget deliberations, while lacking much of the drama of previous years, were widely applauded by editorial observers for their forthrightness and candor. While some concern, for example, was raised over statements by defense director general Koichi Kato that Japanese Self-Defense Forces would, as a matter of course, aid American military vessels outside of Japan's territorial waters, the general reaction in Japan was one of approval, both of the policy and of Mr. Kato's approach to the issue. The spending totals projected in the Japan Defense Agency's new five-year program had few critics -- defense opponents apparently were satisfied by last fall's intra-party debate over retention of the one percent spending limit.

The Nakasone government is working on plans to reorganize the Japanese National Railways into eight separate, private companies and is expected to introduce implementing legislation in the immediate future. JNR's first proposals to transfer redundant employees within JNR or to the private sector have been announced, part of an anticipated drive to find new employment for the 61,000 excess workers in the present system. The bills (five separate